Profit Margin: An Islamic Perspective

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Abstract

This study has been undertaken to explore the Islamic view point about "profit margin". The main focus is to find whether there is a certain limit of profit that is prescribed by Islam or not. It has been observed that Islam, regarding the issue of profitable transaction, takes care of humans who enter a transaction to get benefit and are satisfied by earning some profit at least. So Islam does not confine profit to any specific limit. There are numerous traditions which reveal that any business transaction between two parties is mainly a matter of mutual consent. Therefore, after giving some primary rules about transactions, including the prohibition of interest, uncertainty etc., Islam has given the parties a right to agree on any profit ratio they like, according to their respective situations. Anyhow, there must be the element of "trust" and "honesty" especially in case of *"Buyū' al Amānah"* and if any party fails to observe these, the other party may have the option to cancel the transaction. This is exactly the situation where the topic *of ghaban- e fāḥish* has been discussed by the Muslim jurists. Besides, numerous Islamic traditions also emphasize the element of leniency, brotherhood and cooperation while fixing the price and earning profit

Introduction:

Among all the revealed religions, Islam is said to be the one which has put more stress on economy than any other. Makkah, the birth place of Islam, was a hub of commerce since beginning[1].Trade and business have been an integral part of the Muslims' life since the early days of Islam. Prophet Muhammad (PBUH) is reported to be involved in trade activities before he was given the responsibility to preach Islam. Even many among his renowned companions were those who were famous for their wealth and prosperity. A remarkable fact about this religion is that the longest verse of Quran, the root of Islam, deals with debt

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transaction and its related issues[2]. Khan and Thaut[3] argue that there are many sayings of the Prophet (SAW) that deal with rules and regulation about business transaction. If one tries to compile all these, he will certainly find their number to be in hundred at least. It is due to these very reasons that Islamic jurists declare that basic earning is a religious duty or obligation of every Muslim. Because of this intimate relationship between Islam and trade, the Islamic literature is loaded with the rulings of trade and commerce.

Elements of Contract:

There is a slight controversy among the four schools of thought about the number of elements of contract. But the majority of them agree that there are three basic elements which include: (1) wording or offer and acceptance (2) contractual parties and (3) commodity[4]. However, the *Ḥanafi* School holds that it is only the first which constitutes the essence of any transaction[5]. As for the price, the third element of transaction, which is commodity, includes both commodity and price, and not commodity alone[6]. It means that whatever conditions are necessary for commodity, they will be necessary for price too. Irrespective of the debate about the number of contract elements, both the groups agree on the point that it is a basic essential of the contract that both price and commodity should have certain conditions. These conditions include: (1) both should be lawful (2) should have capability to be delivered (3) both should be in the ownership of the respective parties (4) should be existent (5) should be *māl* (6) should be known. These are some of the conditions which are agreed upon by most juristic schools. There are, off course, some other conditions which are a point of disagreement among them. This shows an agreement among all the schools that the price should be known in such a way that there is no room left for any dispute.

Price in Islam:

Profit is primarily an integral part of price, because price is a whole while profit is a part of it. Therefore, it would be useful to start with a brief discussion about different aspects of price in the light of Islamic *Sharī'ah*.

Difference between *thamn* and *qīmah*:

The first important point to be noticed here is that linguistic differences sometimes create confusion. We have this situation while discussing or searching price in Islamic literature. There are two words in Arabic translated frequently as

"price" in English, but both of them have quite different meanings. These words are *thaman* and *qīmah*. *Thaman* is whatever amount that the two contracting parties agree upon to be the price of the commodity. *Qīmah*, on the other hand, means the internal or actual value of that commodity[7]. For instance, if the actual price of something is rupees 100, it is exactly the *qīmah* of it. Now, if the parties agree on 120, it will be called its *thaman*. It should be noted that when we talk about the issue of price in Islamic perspective, we usually mean "*thaman*" by it i.e. what is agreed upon by the parties, and not "*qīmah*" or its actual value. This distinction will be crucial when a comparison is made between Arabic and Urdu. For those who know Urdu, it would be interesting to note that we do not mean "*qīmah*" when we use the word "*qīmah*" here; we rather mean "*thaman*" by it.

Kinds and conditions of price:

Bashar[8] opines that price is of two kinds: valid and invalid. A valid price is the one which is established in the market and which is according to the dictates of Islamic *Sharī'ah*. In other words, it is a price which is the outcome of the free market forces, is free from fraud, cheating, disguise, and fulfills all other conditions laid down by *Sharī'ah*. An invalid price, on the contrary, is that price which is the result of violating any one or more rules of Islamic law. It may be in the form of coercion (*ikrāh*), or false bidding (*najash*), or taking advantage of the ignorance of the other party. As mentioned earlier, it is obligatory that certain aspects of price should be known in such a way that there is no room for dispute. Ayub[9] has summed up this discussion by stating that there are two conditions regarding price in a valid transaction; it should be known and it should also be specified.

Price fixation in Islam:

Another relevant aspect of the topic under discussion is that whether Islam agrees with fixing the price or not? The study of Islamic literature reveals that Islam does not want the prices to be fixed by someone from outside the market[10]. In other words, Islam wants two major forces of market, supply and demand, to resolve this issue. There is a famous tradition of the Holy Prophet (pbuh) in this regard. According to it, the Prophet (pbuh) refused to fix the prices when he was asked to do so[11]. The jurists have concluded from this tradition that it is not good to disturb the market forces determining prices by external interventions. However, there is also a consensus among them that the government or the relevant authorities must intervene and control the situation if some other unnatural or manmade forces have caused imbalance in market prices. Bashar[12]

concludes this debate by stating that the government can interfere if the market is monopolistic. Similarly, in case of any need or emergency, like war or famine, it is the responsibility of the government to ensure the right of the masses by fixing a fair price.

What is Profit?

The word *RIBḤ* in Arabic can be translated as "profit" in English. The opposite of this word is *KHASĀRAH* which stands for loss. The Arabic word *RIBḤ* literally means any addition in sale and purchase or increase in trade. In other words, it literally means any increase in actual investment which is the result of trade or business. Technically, this word has been defined by different scholar in multiple ways. According to Shakhar[13], the summary of all their definition is that profit is the increase in the actual investment *(RA'S AL MĀL)* which is the result of using it in trade or business. To prove his claim, he quotes Ibn Ḥazam who has defined profit as that specific increase in actual investment which is the outcome of trade. Qaraḍāwi[14], a prominent jurist of the present time, defines profit as the difference between the price of purchase and that of sale when all relevant expenses are added to this price.

There are other words which are near to profit in meaning but there is some difference involved. These words are frequently used in the books of Islamic jurisprudence and it is good to have a brief look into them. They include *namā*, *ziyādah*, *ghalā*, and *fā'idah*. The word *namā* means an increase in wealth as a result of using it or without using it. In the first case, it will be same as profit. The example of the second case, an increase without use, is an animal giving birth to a child. The word *ziyādah* also means abundance or increase and it is the opposite of loss. Technically, *ziyādah* is an increase in something either from within it or outside it, something external. *Ghalā* stands for any usufruct obtained by using something in such a way that the actual thing remains after use. The usufruct may be in the form of crops, fruits, milk, or rental etc. *Fā'idah* is equal to *ghalā* according to majority of the jurists.

Shuwaidah[15] has categorized profit into three types; allowed/recommended *(mashrū'),* prohibited *(ghayr mashrū'),* and controversial *(mukhtalaf fih).* If the profit is the outcome of a permissible bargain like *muḍārabah* etc., it is allowed unanimously. However, all the other necessary condition must also be observed in the transaction. The prohibited profit, on the other hand, is the one which has

been earned as a result of some unlawful act, like interest or gambling. There is a third kind of profit in which there is debate amongst the jurist. Such instances include profit by trustee, or *ghāṣib*.

Profit in relation to time factor (Time value of money):

Ayub[16] documents that there is almost a consensus among jurists that credit price can be higher than the spot price. He claims that it is synonymous to accepting the time value of money as far as price fixation is concerned. However, he elaborates that no increase in the price is allowed in case of delay in payment. He further brings another example which shows the acceptance of time value of money. Islamic law bans the mutual exchange of gold, silver and monetary units unless it is done simultaneously. It is to ensure that none of the parties should take benefit by using what he has received when he has not yet handed over its counter value. A third instance where this situation can be seen is Salam, which means advance payment but deferred delivery, where the price is usually lower than the usual price. Ayub[17] sums up this discussion by declaring that time valuation of money is possible in trade of goods and business, but it is prohibited during the exchange of monetary units, debts, or loans.

Profit margin under Islamic law:

This is the crux of our present study which answers the question of whether Islam has limited the profit margin or not. A thorough study of the relevant material brings forth some very interesting points about this issue. Apparently, there seems to be two opinions regarding this question. According to the first opinion, Islam has restricted the maximum limit of profit to one third. So earning profit above this limit would be unlawful. However, we shall observe soon that this view is very weak and it is the result of some sort of confusion between profit and "*ghaban*", as elaborated by Qaraḍāwi[18]. On the other, the majority of the Islamic scholars, including the four juristic schools, opine that *Sharī'ah* has not limited profit margin, although it has given some general rules in this regard.

First point of view:

Qaraḍāwi[19] argues that it is usually said about the *Māliki* school of thought that they have restricted the highest profit limit to one third. For example, if the original price of a commodity is 30 rupees, its maximum selling price can be 40. Any amount over and above forty will fall under the category of *ghaban* or exorbitant profit which is not allowed. It is said that this stance is based on the

hadith which has restricted will to one third. However, Qaraḍāwi warns that there seems some grave confusion in what is referred to *Mālikis* in this regard. He argues that there is no evidence in the *Māliki* literature which approves this claim. Therefore, it is not right to claim that they have restricted the maximum profit limit one third. This confusion may be the result of their stance about *ghaban* or exorbitant profit. They hold that overpricing over and above one third will be exorbitant. But it does not mean that they have restricted the profit limit to one third.

Second point of view:

The second stand point is what is held by *"Jumhūr"* or majority of Islamic scholars. They are of the opinion that Islam has not restricted profit margin in a transaction. After giving some basic rules about this issue, Islam has left it to the parties to decide what is best in their interest. Before the relevant *aḥādīth* are mentioned, it would be interesting to see what the overall attitude of Islam towards profit is.

According to Qaraḍāwi, an overall study of trade related verses in Qur'an reveal the fact that profit is what business is done for. If someone's business is not profiting, it means there is some problem in his business or in the people that he deals with. In one of the verses, profit has been named as the *faḍl* or blessing of Allah which is not prohibited even in the days of pilgrimage. The study of *aḥādīth*, on the other hand, also shows the same fact. In fact, there are instances in *aḥādīth* in which earning profit has been made compulsory. For instance, Qaraḍāwi[20] quotes one narration mentioned Tirmizi and Ṭabrāni which states that the guardians of the orphans' property must do business in it so that it is not decreased by Zakat. He further concludes from these *aḥādīth* that there should at least be so much profit in business which is enough to pay the Zakat obligation. So Islam accepts profit as the basic motive and incentive behind trade and commerce.

This leads us to the second important question; whether there is a maximum limit for profit? The study of *aḥādīth* proves that there is no such limit prescribed by *Sharī'ah* and this is exactly the stand point of four juristic schools. Qaraḍāwi[21] explains the logic behind this ruling of *Sharī'ah*. According to him, if profit limit were fixed, it would be for every age, every time, and every situation. This would have led to many serious problems indeed. The reason is that there is difference in the commodity one deals in; the edibles expire after a short period,

are grown many times a year, and are needed by everyone. Animals and land are quite different from edibles. Furthermore, some people do business at a small scale; others are the owners of huge companies. Similarly, transaction is sometimes on spot but can be deferred too. In the first case, the profit is less, but it is more in the case of credit. So if *Sharī'ah* had fixed the same amount of profit in all these situations, it would have led to injustice indeed. Therefore, both the parties were given freedom to fix any price they like. However, they must avoid the unlawful practices, which include fraud, deception, swearing, exorbitant pricing and many more. Furthermore, there are other ethics which are found in *aḥādīth* and they should also be observed while fixing a price.

There are numerous traditions which support this claim. The most famous tradition in this regard is the one narrated by 'Urwah Al Bāriqi (r.a.a), which has been mentioned by Bukhāri, Aḥmad, Tirmizi, and Abu Dāwūd etc. According to this *ḥadīth*, the Holy Prophet (pbuh) gave 'Urwah one dinar to buy a goat for him. He went to the market, bought two goats with it, sold one of them for one dinar, and came back to the prophet with a goat and a dinar. When the Holy Prophet (pbuh) came to know about his transaction, he was much pleased with it and prayed for the companion[22]. This is a very strong argument, since this *ḥadīth* has been a part of many major and authentic books of *aḥādīth*. The events in the hadith are too clear and need no explanation. The Holy Prophet (pbuh) not only approved this transaction, he also expressed his happiness at it and prayed for the companion. It clearly indicates that earning 100% profit has been approved by the prophet (pbuh) himself[23].

There is another tradition in Bukhāri which gives detail of a transaction between companions of the Prophet (pbuh). According to it, Zubair b. al 'Awwām, the cousin of the Prophet (pbuh), bought a precious piece of land in Madina at a price of one lakh and seventy thousand. His son, 'Abdullah b. Zubayr, sold this land at a price which was almost ten times more than its cost price; 1.6 million[24]. This shows that earning this amount of profit, or even more than this, is allowed under Islamic law. Otherwise, the companions would not have indulged in it. Likewise, this transaction must have taken place in front of other companions, or they would have come to know about it, at least. Still, it is not recorded that any one of them objected to it on the ground that the profit earned was above 900%. It shows their agreement on the fact that there is no certain maximum profit margin fixed by Islamic law.

However, Qaraḍāwi comes with a word of caution after elaborating this issue. He argues that these examples never mean that a Muslim trader should always go for 100% profit or more than this. These are specific events, taking place at a specific time, among specific people. Therefore, it is not possible to generalize these universally. This is especially true for those who deal in basic necessities of life. Furthermore, these examples also show that the profit earned in these was not earned through hoarding, cheating, exploiting the ignorance of buyer, or his need, or any other method prohibited by *Sharī'ah*. So any amount of profit gained through these methods, even when it is small, would be unlawful in Islamic law. Ayub[25] also observes that Islam leaves both pricing and profit margin to be according to the forces of supply and demand. However, some moral and religious rules have been given which should be observed. The Islamic *Fiqh* Council of the OIC has also agreed that there is no specific profit margin limit under which a trader is bound[26].

There is one more point in these examples which is important in the view of the researcher. The commodities in these instances, i.e. animal, land etc. are such which cannot be termed as the basic necessities of life. Furthermore, these are the type of commodities (especially land or gardens etc.) in which the choice of the buyer and his likeness of the subject matter is more involved rather than his needs. In these cases, one usually does not care for the price he is paying, since he likes the commodity and mostly has enough resources to pay the price. So it is not clear in this context if charging such amount of profit would be allowed in the case of basic necessities too. However, when we observe the general rules and ethics of *Sharī'ah* in bargaining and fixing prices, we find it unlikely to be the case. There are numerous traditions which urge the Muslims to be lenient, cooperative and helpful in pricing. One such tradition records the prayer of the Holy Prophet (pbuh) for a person who is lenient in selling and asking for his right.

Exorbitant Profiteering:

If the profit is earned through deception, it is usually referred to by jurists as *"al-ghabn al-fāḥish"* or exorbitant profiteering. Ayub[27] defines it charging higher than normal price but stating or showing that normal price is charged. Ghazi[28] explains *"al-ghabn al-fāḥish"* as exploiting the need or ignorance of the buyer and charging an amount of profit which exceeds the normally prevalent customary price of market. He further argues that it usually takes place in two forms. Firstly, the buyer is in hurry and cannot ask about the prevalent price in the market. Thus, he

is deceived by the seller by charging high than normal price. Secondly, the buyer is ignorant of the market price of the commodity and is deceived by the seller by charging a high price. *Ghaban* can either serious or non-serious. The first is usually ignorable but the second is not. If the second is accompanied by deception too, then the buyer has the right to revoke the contract too. *Al-Majallah* has tried to fix the ratio of exorbitant profiteering in its section number 165. According to it, charging (1) higher than 5% in general commodities (2) more than 10% in cattle and (3) above 20% in real estate would fall under the category of exorbitant profiteering[29].

Conclusion:

The present study concludes that Islam does not fix a specific rate of profit to be charged. It only gives some general rules and guidelines about price charging. Leniency, brotherhood and mutual help is recommended by Islam. The rest should be left to market mechanism. If the contracting parties agree, there can be any rate of profit fixed in the contract. However, one must observe all the legal and ethical values and commands of Islam.

End Notes

1 Wolf, 1951
2 Quran, 2: 282.
3 Khan and Thaut, 2008
4 Ayub, 2007, p. 106
5 Mansoori, 2011, p. 25
6 Shahada, 2006
7 Zuḥayli, 2001, p. 402
8 Bashar, 1997, pp. 29-52.
9 Ayub, 2007, p. 135
10 Ayub, 2007, p. 138
11 Mansoori, 2011, p: 62.
12 Bashar ,1997
13 Shakhar ,2008
14 Qaraḍāwi ,2008
15 Shuwaidah ,2006
16 Ayub, 2007, p: 89
17 Ayub, 2007, p: 90
18 Qaraḍāwi, 2008.

[19] Qaraḍāwi, 2008
[20] Qaraḍāwi, 2008
[21] Qaraḍāwi, 2008
[22] Ayub, 2007, p. 138
[23] Qaraḍāwi, 2008
[24] Qaraḍāwi, 2008
[25] Ayub, 2007, p. 138
[26] Ayub, 2007, p. 139
[27] Ayub, 2007, p. 139
[28] Ghazi, 2008, p.256
[29] Ghazi, 2008, p. 257

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